AMERICAN PUBLIC EDUCATION INC
Form 10-Q
November 06, 2014

UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

(Mark One)

x QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES AND EXCHANGE ACT OF 1934

For the quarterly period ended September 30, 2014

or

o TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from to

Commission File Number: - 001-33810

AMERICAN PUBLIC EDUCATION, INC.
(Exact name of registrant as specified in its charter)

Delaware	01-0724376
(State or other jurisdiction of Incorporation or organization)	(I.R.S. Employer Identification No.)

111 West Congress Street
Charles Town, West Virginia 25414
(Address, including zip code, of principal executive offices)

(304) 724-3700
(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes x No o

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes x No o

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer, or a smaller reporting company. See the definition of “large accelerated filer,” “accelerated filer” and “smaller reporting company” in Rule 12b-2 of the Exchange Act.

Large accelerated filer x	Accelerated filer o
Non-accelerated filer o (Do not check if a smaller reporting company)	Smaller reporting company o

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes o No x

The total number of shares of common stock outstanding as of November 4, 2014 was 17,264,595.

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PART I – FINANCIAL INFORMATION

Item 1. Financial Statements

AMERICAN PUBLIC EDUCATION, INC.
Consolidated Balance Sheets (Current Period Unaudited)
(In thousands)

	As of September 30, 2014 (Unaudited)		As of December 31, 2013	
ASSETS				
Current assets:				
Cash and cash equivalents	$	108,639	$	94,820
Accounts receivable, net of allowance of $19,364 in 2014 and $13,175 in 2013		6,624		9,520
Prepaid expenses		6,224		5,598
Income tax receivable		—		3,215
Deferred income taxes		8,779		3,432
Total current assets		130,266		116,585
Property and equipment, net		96,188		90,733
Notes receivable		6,400		6,000
Investments		12,190		10,597
Goodwill		38,634		38,148
Other assets, net		8,833		9,592
Total assets	$	292,511	$	271,655
LIABILITIES AND STOCKHOLDERS' EQUITY				
Current liabilities:				
Accounts payable	$	11,888	$	11,563
Accrued liabilities		13,896		17,866
Deferred revenue and student deposits		27,263		24,829
Total current liabilities		53,047		54,258
Deferred income taxes		14,578		10,328
Total liabilities		67,625		64,586
Commitments and contingencies (Note 2)				
Stockholders' equity:				
Preferred stock, $.01 par value; Authorized shares - 10,000; no shares issued or outstanding		—		—
Common stock, $.01 par value; Authorized shares - 100,000; 17,259 issued and outstanding in 2014; 17,578 issued and outstanding in 2013		173		176
Additional paid-in capital		168,169		164,913
Retained earnings		56,544		41,980
Total stockholders' equity		224,886		207,069
Total liabilities and stockholders' equity	$	292,511	$	271,655

The accompanying notes are an integral part of these consolidated financial statements.

AMERICAN PUBLIC EDUCATION, INC.
Consolidated Statements of Income (Unaudited)
(In thousands, except share and per share amounts)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2014	2013	2014	2013
	(Unaudited)		(Unaudited)	
Revenues	$84,707	$81,777	$258,723	$246,542
Costs and expenses:				
Instructional costs and services	30,626	28,139	92,171	83,751
Selling and promotional	17,948	15,989	51,997	48,573
General and administrative	17,432	16,766	55,447	51,403
Depreciation and amortization	4,054	3,376	11,901	9,895
Total costs and expenses	70,060	64,270	211,516	193,622
Income from operations before interest income and income taxes	14,647	17,507	47,207	52,920
Interest income, net	98	77	277	230
Income before income taxes	14,745	17,584	47,484	53,150
Income tax expense	5,877	6,612	18,377	20,006
Equity investment loss, net of taxes	26	61	27	107
Net income	$8,842	$10,911	$29,080	$33,037
Net Income per common share:				
Basic	$0.51	$0.62	$1.67	$1.87
Diluted	$0.51	$0.61	$1.65	$1.84
Weighted average number of common shares:				
Basic	17,255,271	17,658,317	17,394,185	17,689,055
Diluted	17,355,405	17,876,747	17,573,617	17,942,798

The accompanying notes are an integral part of these consolidated financial statements.

AMERICAN PUBLIC EDUCATION, INC.
Consolidated Statements of Cash Flows (Unaudited)
(In thousands)

	Nine Months Ended September 30, 2014	2013
	(Unaudited)	
Operating activities		
Net income	$ 29,080	$ 33,037
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	11,901	9,895
Stock-based compensation	3,691	3,004
Deferred income taxes	(1,097)	1,475
Other	137	244
Changes in operating assets and liabilities:		
Accounts receivable, net of allowance for bad debt	2,896	3,424
Prepaid expenses and other assets	(956)	(6)
Income tax receivable	3,215	3,062
Accounts payable	325	(5,072)
Accrued liabilities	(4,456)	2,151
Deferred revenue and student deposits	2,434	2,985
Net cash provided by operating activities	47,170	54,199
Investing activities		
Capital expenditures	(15,258)	(15,093)
Equity investment	(1,640)	(4,000)
Note receivable	(380)	—
Capitalized program development costs and other assets	(1,045)	(195)
Net cash used in investing activities	(18,323)	(19,288)
Financing activities		
Cash paid for repurchase of common stock	(15,756)	(8,233)
Cash received from issuance of common stock	455	1,718
Excess tax benefit from stock-based compensation	273	483
Net cash used in financing activities	(15,028)	(6,032)
Net increase/(decrease) in cash and cash equivalents	13,819	28,879
Cash and cash equivalents at beginning of period	94,820	114,901
Cash and cash equivalents at end of period	$ 108,639	$ 143,780
Supplemental disclosure of cash flow information		
Income taxes paid	$ 15,096	$ 14,985

The accompanying notes are an integral part of these consolidated financial statements.

AMERICAN PUBLIC EDUCATION, INC.
Notes to Consolidated Financial Statements

1. Nature of the Business

American Public Education, Inc., or APEI, which together with its subsidiaries is referred to as the "Company", is a provider of online and campus-based postsecondary education to approximately 112,600 students through the operations of two subsidiaries:

- American Public University System, Inc., or APUS, provides online postsecondary education directed primarily at the needs of the military and public safety communities through American Military University, or AMU, and American Public University, or APU. APUS is regionally accredited by the Higher Learning Commission.

- National Education Seminars, Inc., which is referred to in these financial statements as Hondros College of Nursing, or HCON, provides on-campus nursing education to students at four campuses in Ohio as well as online to serve the needs of the nursing and healthcare community. HCON is nationally accredited by the Accrediting Council of Independent Colleges and Schools. HCON was acquired by APEI on November 1, 2013.

The Company's institutions are licensed or otherwise authorized, or are in the process of obtaining such licenses or authorizations, to offer postsecondary education programs by state authorities to the extent the Company believes such licenses or authorizations are required, and are certified by the United States Department of Education, or ED, to participate in student financial aid programs authorized under Title IV of the Higher Education Act of 1965, as amended, or Title IV programs.

Our operations are organized into two reportable segments:

- American Public Education Segment, or APEI Segment. This segment reflects the historical operations of APEI prior to the acquisition of HCON and reflects operational activities at APUS, other corporate activities, and minority investments.

- Hondros College of Nursing Segment, or HCON Segment. This segment reflects the operational activities of HCON. The Company acquired HCON on November 1, 2013, and therefore the consolidated results for periods prior to November 1, 2013 do not include any results from HCON.

2. Basis of Presentation

The accompanying unaudited interim consolidated financial statements of the Company have been prepared in accordance with accounting principles generally accepted in the United States, or GAAP. All intercompany transactions have been eliminated in consolidation. The financial statements do not include all of the information and footnotes required by GAAP for complete financial statement presentations. In the opinion of management, these statements include all adjustments (consisting of normal recurring adjustments) considered necessary to present a fair statement of the Company's consolidated results of operations, financial position and cash flows. Operating results for any interim period are not necessarily indicative of the results that may be expected for the year ending December 31, 2014. This Quarterly Report on Form 10-Q should be read in conjunction with the Company's consolidated financial statements and footnotes in its audited financial statements included in its Annual Report on Form 10-K for the year ended December 31, 2013.

Use of Estimates

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts in the consolidated financial statements and accompanying notes. Actual results could differ from those estimates.

Recent Accounting Pronouncements

In May 2014, the FASB issued ASU No. 2014-09, “Revenue from Contracts with Customers (Topic 606)” (“ASU 2014-09”). The standard is a comprehensive new revenue recognition model that requires revenue to be recognized in a manner to depict the transfer of goods or services to a customer at an amount that reflects the consideration expected to be received in exchange for those goods or services. ASU 2014-09 is effective for fiscal years, and interim periods within those years, beginning after December 15, 2016, and early adoption is not permitted. Accordingly, the standard will only be effective for the Company for periods beginning on or after January 1, 2017. We will evaluate the impact that the standard will have on our financial condition, results of operations, and disclosures.

In August 2014, the FASB issued ASU No. 2014-15, “Disclosure of Uncertainties about an Entity’s Ability to Continue as a Going Concern” (“ASU 2014-15”). The standard requires management to evaluate, at each interim and annual reporting period, whether there are conditions or events that raise substantial doubt about the entity’s ability to continue as a going concern within one year after the date the financial statements are issued, and provide related disclosures. ASU 2014-15 is effective for annual periods ending after December 15, 2016, and for annual and interim periods thereafter, and early adoption is permitted. We do not expect to early adopt ASU 2014-15, which will be effective for us for our fiscal year ending December 31, 2016, and we do not believe the standard will have a material impact on our financial statements.

There have been no other applicable pronouncements since the Company's Annual Report on Form 10-K for the year ended December 31, 2013.

Investments

On February 20, 2013, the Company made a $4.0 million investment in preferred stock of Fidelis Education, Inc., or Fidelis Education, representing approximately 21.6% of its fully diluted equity. Fidelis Education is developing a learning relationship management system that will assist working adult students with education advising and career mentoring services as they pursue college degrees. In connection with the investment, the Company is entitled to certain rights, including right to representation on the Board of Directors. The Company accounts for its investment in Fidelis Education under the equity method of accounting. Therefore, the Company recorded the investment at cost and records its share of earnings or losses in the investee in the periods for which they are reported with a corresponding adjustment in the carrying amount of the investment.

On April 2, 2014, the Company made a $1.5 million investment in preferred stock of Second Avenue Software, Inc. representing approximately 25.9% of its fully diluted equity. Second Avenue Software is a game-based education software company that develops software on a proprietary and “work-for-hire” basis. In connection with the investment, the Company is entitled to certain rights, including right to representation on the Board of Directors. The Company accounts for its investment in Second Avenue Software under the equity method of accounting. Therefore, the Company recorded the investment at cost and will recognize its share of earnings or losses in the investee in the periods for which they are reported with a corresponding adjustment in the carrying amount of the investment.

Notes Receivable

The Company evaluates notes receivable by analyzing the borrower's creditworthiness, cash flows and financial status, and the condition and estimated value of the collateral. The Company considers a note receivable to be impaired when, based upon current information and events, the Company believes it is probable that the Company will be unable to collect all amounts due according to the contractual terms of the loan agreement.

Commitments and Contingencies

The Company accrues for costs associated with contingencies including, but not limited to, regulatory compliance and legal matters when such costs are probable and can be reasonably estimated. Liabilities established to provide for contingencies are adjusted as further information develops, circumstances change, or contingencies are resolved. The Company bases these accruals on management's estimate of such costs, which may vary from the ultimate cost and expenses associated with any such contingency.

HCON entered into an operating lease agreement with an initial term of 15 years that commenced on July 1, 2014. The operating lease requires monthly base rent payments in the amount of $38,710 for years one to five, $39,632 for years six to ten, and $41,475 for years 11 to 15. The lease also provides for an annual upward rent adjustment for HCON's pro-rata share of any increase in the landlord's total building operating costs, provided that HCON's pro-rata share of any increase related to the landlord's controllable operating costs cannot exceed 10% per annum. HCON has an option to terminate the lease at the end of the one hundred twentieth (120th) month of the lease term subject to payment of a $263,923 termination fee.

From time to time, the Company may be involved in litigation in the normal course of its business. The Company is not aware of any pending or threatened litigation matters the resolution of which, in the opinion of management, will have a material adverse effect on the Company's business, operations, financial condition or cash flows.

On or about November 18, 2013, a putative class action styled Tabatha Vickery, Bryan Lynn, on behalf of themselves and a similarly situated class v. Hondros College, Inc. and John G. Hondros, was filed in the Court of Common Pleas, Cuyahoga County, Ohio, as Case No. CV 13 817299. National Education Seminars, Inc., which we refer to as Hondros College of Nursing, or HCON, was not named in the lawsuit, but a then member of HCON's board of directors, John Hondros, was named in the lawsuit, and the allegations made in the Complaint related to HCON's operations and not the operations of the entity named in the lawsuit. The lawsuit asserted claims for fraud and fraudulent inducement, negligent misrepresentation, breach of implied-in-fact contract, promissory estoppel, unjust enrichment, and violation of the Ohio Consumer Sales Practices Act, for, among other things, the alleged provision of false or misleading information to the named plaintiffs and other putative class members in 2011 and 2012 regarding the status of accreditation by National League for Nursing Accrediting Commission of HCON's Associate Degree in Nursing, or ADN, program offered at its Independence, Ohio campus. The plaintiffs alleged that the putative class consisted of more than 60 former students who in the summer or fall quarters of 2011 enrolled in the ADN or the licensed practical nursing, or LPN, program at the Independence campus with the intention of pursuing a degree in nursing, but who withdrew from the ADN or LPN program. On February 11, 2014, the plaintiffs filed their First Amended Complaint, which removed Hondros College, Inc. as a defendant and added HCON as a defendant. On February 24, 2014, the defendants filed a motion to dismiss with prejudice the plaintiffs' First Amended Complaint. On April 1, 2014, the plaintiffs filed their opposition to the motion to dismiss. On April 10, 2014, the defendants filed their reply brief in support of the motion to dismiss. The Company is currently unable to estimate the likelihood or range of reasonably probable loss, if any, for this matter. The Company does not believe, based on currently available information, that the outcome of this proceeding, if adverse to HCON, would have a material adverse effect on the Company's financial condition.

Concentration

Approximately 36% and 35% of the APEI segment's revenues for the three and nine month periods ended September 30, 2014 were derived from students using financial aid under the Title IV programs, compared to 37% and 36% of the APEI segment's revenues for the three and nine month periods ended September 30, 2013. Approximately 34% and 35% of the APEI segment's revenues for the three and nine month periods ended September 30, 2014 were derived from students who received tuition assistance from tuition assistance programs sponsored by the United States Department of Defense, or DoD, compared to approximately 36% and 37% of the APEI segment's revenues for the three and nine month periods ended September 30, 2013. Approximately 18% of the APEI segment's revenues for the three and nine month periods ended September 30, 2014 were derived from students who were eligible for veterans benefits, compared to approximately 16% of the APEI segment's revenues for the three and nine month periods ended September 30, 2013. A reduction in any of these programs or a change in the benefits allowed to students thereunder could have a significant impact on the APEI segment's operations.

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3. Net Income Per Common Share

Basic net income per common share is based on the weighted average number of shares of common stock outstanding during the period. Diluted net income per common share increases the shares used in the per share calculation by the dilutive effects of options and restricted stock. Stock options are not included in the computation of diluted earnings per share when their effect is anti-dilutive. There were 358,940 and 214,579 anti-dilutive stock options excluded from the calculation for the three and nine months ended September 30, 2014, respectively, compared to 0 and 169,837 anti-dilutive stock options excluded from the calculation for the three and nine month periods ended September 30, 2013, respectively.

4. Income Taxes

The Company is subject to U.S. Federal income taxes as well as income taxes of multiple state jurisdictions. For Federal and state tax purposes, the tax years from 2011 to 2013 remain open to examination.

5. Stock-Based Compensation

On March 15, 2011, the Board of Directors adopted the American Public Education, Inc. 2011 Omnibus Incentive Plan, or the “2011 Incentive Plan”, and the Company's stockholders approved the 2011 Incentive Plan on May 6, 2011, at which time the 2011 Incentive Plan became effective. Upon effectiveness of the 2011 Incentive Plan, the Company ceased making awards under the American Public Education, Inc. 2007 Omnibus Incentive Plan, or the “2007 Incentive Plan”. The 2011 Incentive Plan allows the Company to grant up to 2,000,000 shares plus any shares of common stock that are subject to outstanding awards under the 2007 Incentive Plan or the American Public Education, Inc. 2002 Stock Incentive Plan, or the “2002 Stock Plan”, that terminate due to expiration, forfeiture, cancellation or otherwise without the issuance of such shares. As of September 30, 2014, there were 249,802 shares subject to outstanding awards under the 2011 Incentive Plan, and 453,231 shares subject to outstanding awards under the 2007 Stock Plan and the 2002 Incentive Plan. Awards under the 2011 Incentive Plan may include the following award types: stock options, which may be either incentive stock options or nonqualified stock options; stock appreciation rights; restricted stock; restricted stock units; dividend equivalent rights; performance shares; performance units; cash-based awards; other stock-based awards, including unrestricted shares; or any combination of the foregoing.

Stock-based compensation expense related to restricted stock grants is expensed over the vesting period using the straight-line method for Company employees and the graded-vesting method for members of the Board of Directors and is measured using the Company's stock price on the date of grant. The fair value of each option award is estimated at the date of grant using a Black-Scholes option-pricing model. Prior to 2012, the Company calculated the expected term of stock option awards using the “simplified method” in accordance with Staff Accounting Bulletins No. 107 and 110 because the Company lacked sufficient historical data and was unable to make reasonable expectations regarding the future. The Company also estimates forfeitures of share-based awards at the time of grant and revises such estimates in subsequent periods if actual forfeitures differ from original projections. The Company makes assumptions with respect to expected stock price volatility based on the average historical volatility of the stock prices of peers with similar attributes. In addition, the Company determines the risk-free interest rate by selecting the U.S. Treasury five-year constant maturity, quoted on an investment basis in effect at the time of grant for that business day. Estimates of fair value are subjective and are not intended to predict actual future events, and subsequent events are not indicative of the reasonableness of the original estimates of fair value made under FASB ASC Topic 718. In the nine month periods ended September 30, 2014 and September 30, 2013 there were no options granted.

Options previously granted vest ratably over periods of three to five years and expire in seven to ten years from the date of grant. Option activity is summarized as follows (unaudited):

	Number of Options	Weighted Average Exercise Price	Weighted-Average Contractual Life (Yrs)	Aggregate Intrinsic Value (In thousands)
Outstanding, December 31, 2013	501,202	$ 28.82		
Options granted	—	$ —		
Awards exercised	(36,443)	$ 12.49		
Awards forfeited	(11,528)	$ 37.26		
Outstanding, September 30, 2014	453,231	$ 29.92	2.36	$ 2,024
Exercisable, September 30, 2014	453,231	$ 29.92	2.36	$ 2,024

The following table summarizes information regarding stock option exercises (unaudited):

	September 30, 2014	September 30, 2013
	(In thousands)	
Proceeds from stock options exercised	$ 455	$